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In the Supreme Court of the United States

OCTOBER TERM, 1992

CHARLES L. HONEY,
PETITIONER
v.
UNITED STATES OF AMERICA,
RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF OF PETITIONER

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REPLY BRIEF FOR THE PETITIONER

The brevity of the government's argument in its Brief in Opposition in response to the three specific questions presented by the Petitioner, represents the government's continual monolithic assertion of its "strict liability" argument (first asserted before this Court in *Slodov v. United States*, 436 U.S. 238 (1978)) for the imposition of the "100% penalty" provided by 26 U.S.C. § 6672. The government's apparent refusal to address the merits of the substantive arguments raised by the Petitioner, especially with regard to the applicability of the "brightline rules" mandated by this Court in its *Slodov* opinion, represents the government's arrogant use of this heavy "100% penalty" to try and impose liability for this penalty, "as a matter of law," especially in situations where juries have found, "as a matter of fact," that the responsible person

did *not* act *willfully* (as required by § 6672) in causing the failure of the corporate employer to pay over the withheld "trust fund" payroll taxes, where those payroll taxes have been dissipated by prior management without the knowledge of the responsible person.

The following points are addressed to the government's assertions, in its Brief in Opposition, that there are no conflicts between the decision in this case and this Court's prior decision in *Slodov*, as well as the decisions of other inferior federal courts, on the three questions presented by this Petition.

I. THE GOVERNMENT'S ARGUMENT THAT THE PETITIONER ACTED "WILLFULLY," AS A MATTER OF LAW, IS AN IMPROPER INTERPRETATION OF THIS COURT'S BRIGHT LINE RULES LAID DOWN BY THIS COURT IN *SLODOV* FOR ADMINISTERING THE "100% PENALTY," AND THE EIGHTH CIRCUIT'S ACCEPTANCE OF THE GOVERNMENT'S ARGUMENT, CONFLICTS WITH DECISIONS OF OTHER FEDERAL CIRCUIT COURTS.

Without addressing the obvious question of how any "trust fund" status (26 U.S.C. § 7501) can be imposed upon "after acquired funds" of a corporation (when the actual withheld payroll taxes have been dissipated by prior management, *before* the responsible person becomes knowledgeable of such fact), the government argues (Br. Opp. 6–8), on the first question presented here, that a responsible person (in a factual setting like that of the Petitioner in this case) has an absolute and continuing duty to apply *all* unencumbered funds received by the corporation to satisfy the prior payroll tax delinquencies. In essence, the government is again asserting its "strict liability" argument that it proffered to this Court in the *Slodov* case, based solely upon the corporate shareholder's *status* as a responsible person, without there being any showing of either (1) *willfulness* on the part of the responsible person to pay over the delinquent employment taxes, or (2) any

nexus between the withheld payroll taxes that give rise to the "100% penalty" assessment, and the after acquired funds of the corporation.

Instead of applying the surgeon's scalpel to the facts presented to determine the elements of *willfulness* on the part of the responsible person (as this Court did in its *Slodov* decision), the government simply wields a blunt hatchet in stating its legal position where its attempt to cut off, "as a matter of law," the Petitioner's right to claim the safe harbor limitations on the "100% penalty" mandated by this Court in *Slodov*. The government's basic argument is essentially the same as the one rejected by this Court in *Slodov*, i.e. once a responsible officer, the willfulness factor can be attributed at any time, even after the taxable quarters have closed and there is no *nexus* to the delinquent payroll taxes, if corporate funds are ever paid to other creditors.

a. There is a conflict between the Eighth Circuit's decision in this case, and decisions of other federal circuit courts, regarding the applicability of the "as a matter of law" standard argued by the government.

A review of the government's general litigating position in "100% penalty" cases, since this Court rendered its *Slodov* decision, reveals that the IRS usually applies the shotgun approach of assessing this heavy civil penalty against every possible responsible officer, and then the government urges the district and appellate courts to hold such individuals liable for this heavy penalty, "as a matter of law," wherever the facts present an instance in which other corporate creditors were paid with the corporation's after acquired funds. Besides the arguments on this point that are set forth by Charles Honey in his original Petition (Pet. 16–24), the Petitioner submits that the very recent decision by the Fourth Circuit Court of Appeals in the case of *Turpin v. United States*, 970 F.2d 1344 (C.A.4, 1992) is in direct conflict with the decision of the Eighth Circuit Court of Appeals in this *Honey* case, regarding

the proper application of the *willfulness* standard of § 6672. [1] In its recent *Turpin* decision, the Fourth Circuit specifically reversed the district court's granting of *judgment notwithstanding the verdict* for the government, where the district court overruled the jury's factual findings and held that Mr. Turpin had acted *willfully*, "as a matter of law," in allowing other creditors to be paid with the corporation's after acquired funds. As in the instant *Honey* case, the jury in the *Turpin* case had found that the corporate shareholder was a responsible person throughout the period in which the payroll tax delinquencies accrued, but the jury in *Turpin* specifically found that Mr. Turpin had *not* acted *willfully* in allowing these payroll tax delinquencies to accrue. [2]

Thus, even though Charles Honey and Henry Turpin were found, "as a matter of fact," by two juries to have been in virtually

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[1] The time within which the government could have filed a timely Petition for Certiorari to this Court in the *Turpin* case expired on October 15, 1992, without the filing of such a Petition by the government. Therefore, an additional reason now exists for this Court to grant the Petitioner's request for review of the Eighth Circuit's decision in the instant case, because there now exists a clear and direct conflict between decisions of the Eighth Circuit and the Fourth Circuit as to how this "willfulness" standard mandated by this Court in its *Slodov* decision is to be applied in very similar factual circumstances.

[2] This is exactly the same factual situation that is presented in the instant case, since the jury in the district court here found that Mr. Honey was a responsible person throughout the nine (9) month period that the payroll tax delinquencies accrued, but that Mr. Honey had *not* acted *willfully* in allowing such payroll tax delinquencies to accrue for the first seven (7) months of this nine (9) month period. (See, jury's answers to special interrogatories (a), (b) and (c), Pet. App. D, Pet. 34a–36a). Also, it should be noted that the government never raised this "duty to use after acquired funds" argument in the *Turpin* case, even though it is obvious from the Fourth Circuit's opinion that Mr. Turpin continued to be active in the corporate employer's business for more than four months after the last quarter for which the payroll tax delinquencies accrued. Finally, the Fourth Circuit specifically noted this Court's limitation on the use of the term "responsible officer," in footnote 7 of its *Slodov* decision, and that circuit court applied the same limitation in reaching its decision in the *Turpin* case. 970 F.2d, at 1347, ftnt. 3.

the same position, the government's assertion of this "100% penalty" against each of these individuals has resulted in totally different determinations, solely because of antonymous interpretations made by the Eighth Circuit and the Fourth Circuit of this Court's bright line rules mandated in *Slodov* for the administration of the "100% penalty" provided by § 6672. Under virtually the same factual circumstances, Mr. Turpin has been found to qualify for the safe harbor limitations from this extremely heavy penalty (because of the jury's finding of his lack of *willfulness)*, but Mr. Honey has been denied the benefit of this same safe harbor and he must suffer the imposition of this heavy penalty, "as a matter of law," even though his jury had also found that he had not acted *willfully* in allowing the payroll tax delinquencies to accrue. The Eighth Circuit's erroneous interpretation of this Court's bright line rule mandated by *Slodov* has resulted in Mr. Honey being placed in a totally different financial condition, regarding his liability for this penalty, than the Fourth Circuit has placed Mr. Turpin, who is a similarly situated person.

Other recent decisions of federal appellate courts have also rejected the government's continually asserted "litigating position" that responsible persons are strictly liable for this 100% penalty, "as a matter of law." See the decision of the Seventh Circuit in *Sawyer v. United States*, 831 F.2d 755 (C.A.7, 1987) and the Fifth Circuit in *Gustin v. United States*, 876 F.2d 485 (C.A.5, 1989). [3]

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[3] The Petitioner also points out that the rationale adopted by the Fifth Circuit's decision in its *Gustin* case, in effect, undercuts the rationale of the Fifth Circuit's earlier decision in *Mazo v. United States*, 591 F.2d 1151 (C.A.5), *cert. denied*, 444 U.S. 842 (1979). This *Mazo* decision is the seminal case cited by the government that erroneously adopted the government's argument for distinguishing the applicability of this Court's *Slodov* standards for *willfulness* under § 6672 in situations where the responsible person had no knowledge of the accrual of the payroll tax delinquencies, until after they accrue and the "trust fund" moneys had been dissipated by others. The Petitioners notes that the government cites language from this *Mazo* decision by the Fifth Circuit (Br. Opp. 7) as its base of authority for the legal position it attempts to defend in this proceeding.

This Court should grant Charles Honey's Petition in this case, so as to utilize the facts of this case as a vehicle for clarifying the applicability of the *willfulness* standards this Court originally mandated in *Slodov* to factual situations (like those presented here) that have no real distinguishing characteristics from those presented in *Slodov*. The government has continually argued to the inferior federal courts that the responsible person's *status* alone is sufficient reason to distinguish these cases from *Slodov*, and is sufficient reason to hold these responsible persons *willful* (and strictly liable for this heavy "100% penalty"), "as a matter of law," even though such responsible persons (like Dr. Slodov) were not knowledgeable of the payroll tax delinquencies when they accrued and there were no traceable "trust funds" (available with a *nexus* to these delinquent payroll taxes) when the responsible persons acquired effective financial control of the corporate employer. It is obvious that there is confusion and conflict on this question among the decisions of the inferior federal courts, as noted in Mr. Honey's Petition (Pet. 17–19). The Petitioner in this case should not be made to suffer the devastating financial consequences that flow from the Eighth Circuit's erroneous application of the *willfulness* standards, when similarly situated responsible officers have been excused from such penalty by the correct application of such *willfulness* standards by the Fourth Circuit and other inferior federal courts.

II. THE QUESTION OF WHAT CONSTITUTES UNENCUMBERED FUNDS IS AN IMPORTANT ISSUE THAT HAS NOT PREVIOUSLY BEEN ADDRESSED DEFINITIVELY BY THIS COURT, BUT SHOULD BE ADDRESSED IN THIS CASE

In attempting to respond to the Petitioner's arguments on the second question raised in his Petition (Pet. 24–27), the government does *not* even mention, let alone rebut, the Petitioner's citation to this Court's ruling in *Slodov* (436 U.S. at 259) on the use

of these after acquired funds by the responsible person. [4] Instead, the government merely argues (Br. Opp. 8–10) that the after acquired funds held in the corporate employer's bank account in this case were unencumbered (even though there was a superior security interest in *all* such funds in favor of a third party bank), because the holder of the security interest did not direct as to what corporate creditors could be paid with these funds by Phoenix Housing in the company's day–to–day operations. Such an incredibly narrow definition of "unencumbered funds," for purposes of § 6672, is not in accord with the policy considerations addressed by this Court in its *Slodov* opinion regarding the collection of taxes versus the rehabilitation of financially troubled businesses. Also, the government's argument fails to note that such directive action by the bank (as the security interest holder) might well expose the bank to a similar penalty liability for these delinquent payroll taxes. (26 U.S.C. § § 3505 and 6672).

In this case, it was quite evident that the total of $114,000.00 would *not* have been run through the corporate bank account in the last two months of the corporation's operations, [5] if any substantial portion of those moneys had been used to pay the prior corporate payroll tax delinquencies, instead of the then current payrolls of the corporation's employees. Clearly, the employees would have quit, the corporation would have ceased operations earlier, and the government's measure of the responsible officer's liability would have been reduced substantially in this case, because $114,000.00 would *not* have been generated from the

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[4] There, this Court noted that surely Congress did not intend to hammer a responsible person with the threat of a heavy "100% penalty" for the responsible person's failure to direct the payment of after acquired corporate funds to satisfy prior payroll tax delinquencies when the IRS could *not* assert a superior security or lien interest in such after acquired funds, if the IRS levied directly upon such funds.

[5] With $114,000.00 includes $20,000.00 personally borrowed and contributed to Phoenix Housing by James Meador, one of the other persons assessed with the "100% penalty" in this case.

corporation's "business cycle" of depositing proceeds from accounts receivable into the corporate bank account. This is exactly the situation that was cogently addressed by District Judge Morris Arnold in his Opinion in this case (760 F. Supp. 754) where he stated (Pet. 27a):

> Because the government's test perhaps has about it a deceptive aura of rectitude and equity, and might therefore seem to be the one the court should adopt, the court will devote some discussion to demonstrate the unreliability of its proposed method.

The district judge then demonstrated, by illustrative example, why the redeposit of proceeds collected in the business cycle into the corporate bank account should *not* be used as the sole measure for a corporation's available "unencumbered funds."

Since the only decision of this Court addressing this important "unencumbered funds" issue is the mention of such terms in this Court's *Slodov* decision (436 U.S. at 259), and because the rationale adopted by the Eighth Circuit for the measurement of "unencumbered funds" in this case is diametrically opposed to the rationale set forth by this Court in *Slodov*, the Petitioner submits that the Court should grant his Petition and utilize this case to render a definitive opinion regarding this "unencumbered funds" issue.

III. THE CIRCUIT COURT'S RENDERING OF A DECISION FOR THE GOVERNMENT, INSTEAD OF REMANDING THE FACTUAL QUESTION TO THE DISTRICT COURT, DENIES THE PETITIONER HIS RIGHTS TO PROCEDURAL DUE PROCESS.

The question of what constitutes "unencumbered funds," for purposes of the applicability of the "100% penalty" provided by § 6672, was decided by the Eighth Circuit, on appeal, in this very case. Though this factual question was reserved by the parties to

the district court, the district court's findings on this issue were inextricably intertwined with the findings of the jury regarding the Petitioner's status as a responsible person and his lack of willfulness, under the standards set by this Court for imposing liability for this heavy penalty under § 6672.

Clearly, pursuant to the provisions of Rule 50(d) of the Federal Rules of Civil Procedure, Petitioner Honey timely filed a formal written request for a new trial with the circuit court, prior to the submission of this case to that court for decision. The Eighth Circuit's decision granted, "as a matter of law," what was, *in effect*, the government's unfiled motion *jnov*, by holding that the Petitioner had acted *willfully* in failing to pay over after acquired funds of the corporate employer to the IRS to satisfy the corporation's prior payroll tax delinquencies. In essence, there is absolutely no difference between the thrust of the government's "litigating position" in this *Honey* case, and its "litigating position" in the *Turpin, supra,* case, except that the net result of the Fourth Circuit's decision, in interpreting this Court's *Slodov* standards, upheld the jury's determination, and the Eighth Circuit, in misapplying this Court's *Slodov* standards has refused to accept the jury's findings *or* to give the Petitioner an opportunity to submit this factual question to a jury.

When the rules of the game are changed or set by the appellate court, on an appeal in the case being reviewed, it is only equitable that the Petitioner be entitled to at least the opportunity to try to meet his burden of proof under the *new* standards adopted by the Eighth Circuit for imposing liability under § 6672. Therefore, the Petitioner submits that the government has offered no cogent reason (Br. Opp. 10) as to why he should not be entitled to a new trial on the factual question on the availability of "unencumbered funds" in this case, as opposed to being held strictly liable for this heavy penalty, "as a matter of law," based upon *new* standards and rules adopted by the Circuit Court on appeal in this case itself.

CONCLUSION

For the foregoing reasons, the Petitioner submits that his Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit should be granted.

Respectfully submitted,

DECEMBER 1, 1992

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